

Chapter 6

Control accounts, errors and omissions

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Coverage of this Chapter

1. Control Accounts
2. Bank Reconciliation
3. Correction Entries

What are control accounts?

- ▶ Nominal ledger account in which a record is kept of the total value of a number of similar individual items. Control accounts are used chiefly for trade receivables and payables.
- ▶ A control account is an account which keeps a total record for a collective item (e.g. receivables), which in reality consists of many individual items (e.g. individual trade receivables).

Problem:1

Payables control account

A payables control account contains the following entries:

- ▶ Bank CU 79,500
- ▶ Credit purchases CU 83,200
- ▶ Discount received CU 3,750
- ▶ Contra with receivables control account CU4,000
- ▶ Balance c/d at 31 December 20X8 CU 12,920

Requirement:

There are no other entries in the account. What was the opening balance brought down at 1 January 20X8?

Problem:2

Receivables control account

The total of the balances in a company's receivables ledger is CU800 more than the debit balance on its receivables control account.

Which one of the following errors could by itself account for the discrepancy?

- A. The sales day book total column has been undercast by CU800
- B. Cash discounts totalling CU800 have been omitted from the nominal ledger
- C. One receivables ledger account with a credit balance of CU800 has been treated as a debit balance in the list of balances
- D. The cash receipts book has been undercast by CU800

Problem:3

Receivables and payables control accounts

For Exports Co on 1 October 20X8 the receivables ledger balances were CU8,024 debit and CU57 credit, and the payables ledger balances on the same date were CU6,235 credit and CU105 debit. These balances have been checked and are correct.

For the year ended 30 September 20X9 the following particulars are available.

- ▶ Sales CU 62,514
- ▶ Purchases CU 39,439
- ▶ Cash from credit customers CU 55,212
- ▶ Cash to credit suppliers CU 37,307
- ▶ Discount received CU 1,475
- ▶ Discount allowed CU 2,328
- ▶ Irrecoverable debts written off CU 326
- ▶ Cash received in respect of debit balances in payables ledger (refunds from suppliers) CU 105
- ▶ Amount due from customer as shown by receivables ledger, offset against amount due to the same firm as shown by payables ledger (settlement by contra) CU 434

What are the balances as at 30 September 20X9 on:

- (a) Receivables control account
- (b) Payables control account?

Why do we use control accounts?

- ▶ They help **check the accuracy** of entries made
 - (i) The receivables control account balance is compared with the total of individual balances on the personal accounts in the receivables ledger.
 - (ii) The payables control account balance is compared with the total of individual balances on the personal accounts in the payables ledger.
- ▶ They help us **locate errors** in postings promptly.
- ▶ They **provide an internal check**.
- ▶ They **provide total receivables and payables balances** more quickly for producing a trial balance or balance sheet.
- ▶ They keep the number of accounts in the trial balance down to a **manageable size**, since the personal

Problem:4

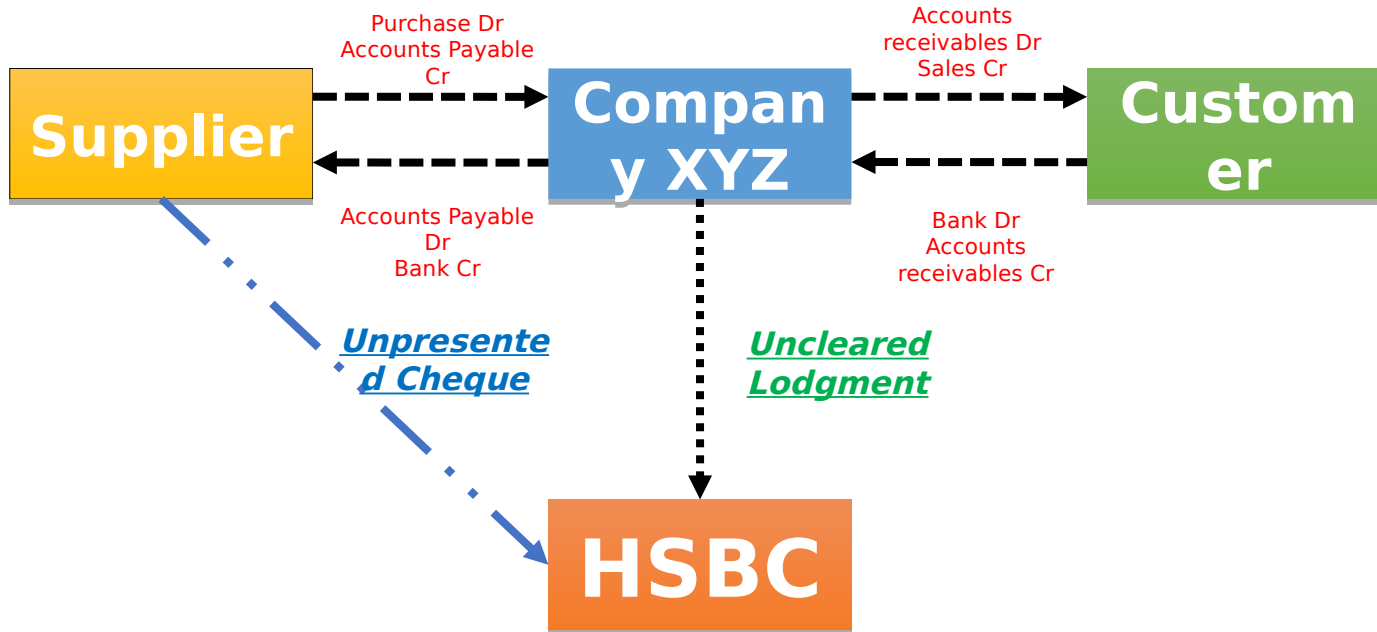
April Showers sells goods on credit to most of its customers and maintains a receivables control account. For the year to 30 October 20X3 the accountant discovers that the total of all personal accounts in the receivables ledger is CU12,802, whereas the receivables control account balance is CU12,550.

The following errors are discovered.

- (a) Sales for the week ending 27 March 20X3 amounting to CU850 had been omitted from the control account.
- (b) A customer's debit balance of CU300 had not been included in the list of balances.
- (c) Cash received of CU750 had been entered in a personal account as CU570.
- (d) Discount allowed totalling CU100 had not been entered in the control account.
- (e) A personal account debit balance had been undercast by CU200.
- (f) A contra item of CU400 with the payables ledger had not been entered in the control account.
- (g) An irrecoverable debt of CU500 had not been entered in the control account.
- (h) Cash received of CU250 had been debited to a personal account.
- (i) Discounts received of CU50 had been debited to Bell's receivables ledger account.
- (j) A Credit note for CU200 had been omitted from the casting of the sales day book.
- (k) Cash received of CU80 had been credited to a personal account as CU8.
- (l) A cheque for CU300 received from a customer and entered in the control account and personal account had been dishonoured by the bank, but no adjustment had been made in the control account.

Requirements

- (a) Prepare a corrected receivables control account, bringing down the amended balance as at 1 November 20X3.



Bank Reconciliation Process

1. 1st Step- Correct cash book

2. 2nd step- Start reconciliation from ***the Balance as per Bank Statement*** to reach at Corrected cash book

Disagreement with the cash book

There are five common explanations for **differences between cash book and bank statement**.

- ▶ **Error**
- ▶ **Bank charges or bank interest**
- ▶ **Automated payments and receipts**
- ▶ **Dishonored cheques**
- ▶ **Timing differences**
 - There may be some **cheques received**, recorded in the cash book and paid into the bank, but which have not yet been '**cleared**' (paid by the bank) and added to the account by the bank. So although the business's records show that some cash has been added to the account, it has not yet been acknowledged by the bank – although it will be soon, once the cheque has cleared.
 - Similarly, the business might have made some **payments by cheque**, and reduced the balance in the cash book accordingly, but the person who receives the cheque might not bank it for a while. Even when it is banked, it takes a day or two for the bank to process it and for the money to be deducted from the account.

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All these differences need to be identified and eradicated,

The bank reconciliation

(1)

- ✦ The cash book needs to be regularly reconciled to the bank statement.
- ▶ The cash book and bank statement usually fail to agree because of: errors in the cash book or by the bank; bank charges and interest not entered in the cash book; automated payments and receipts not entered in the cash book; customers' cheques dishonoured or returned unpaid by the bank, not entered in the cash book; timing differences between the cash book and the bank statement (the cash book is usually more up-to-date: unpresented cheques and uncredited lodgements).
- ▶ Often correcting or additional entries are needed in the cash book as a result of the bank reconciliation; the bank statement then agrees/reconciles with the corrected cash book balance once timing differences are taken into account.

The bank reconciliation

- ▶ **(2) Bank reconciliation:** A comparison of a bank statement (sent monthly, weekly or even daily by the bank) with the cash book. Differences between the balance on the bank statement and the balance in the cash book should be identified and satisfactorily reconciled.

The bank reconciliation (3)

When doing a bank reconciliation, you will have to look for the following items on the bank statement and in the cash book.

- (a) **Errors in the cash book**, such as transposition errors (e.g. writing CU36 and CU63) or cheques sent out but omitted from the cash book. The correct amount appears on the bank statement and the cash book must be updated.
- (b) **Corrections and adjustments to the cash book**
 - (i) Payments made into or from the bank account by way of standing order, direct debit or online transfer which have not yet been entered in the cash book.
 - (ii) Bank interest and bank charges, not yet entered in the cash book.
 - (iii) Dishonoured cheques not yet entered in the cash book.
- (c) Errors in the bank statement, such as transposition errors, payments or receipts recorded twice or interest and fees deducted incorrectly. The correct amount appears in the cash book and the balance per the bank statement must be corrected.
- (d) Items reconciling the correct cash book balance to the bank statement (timing differences)
 - (i) Cheques paid out by the business and credited in the cash book which have not yet been presented to the bank, or 'cleared', and so do not yet appear on the bank statement. These are known as '**unpresented cheques**'.
 - (ii) Cheques received by the business, paid into the bank and debited in the cash book, but which have not yet been cleared and entered in the bank account, and so do not yet appear on the bank statement. These are known as '**uncleared lodgements**'.

Problem:5

At 30 September 20X6, the balance in Wordsworth Co's cash book was CU805.15 debit. A bank statement on 30 September 20X6 showed Wordsworth Co to be in credit at the bank by CU1,112.30.

On investigation of the difference, it was established that:

- (a) The cash book had been undercast by CU90.00 on the debit side.
- (b) Cheques paid in but not yet credited by the bank were CU208.20.
- (c) Cheques drawn not yet presented to the bank were CU425.35.

We need to show the correction to the cash book, then prepare a statement reconciling the balance per the bank statement to the balance per the cash book.

Problem:6

At his year end of 30 June 20X0, Cook's cash book showed that he had an overdraft of CU300 on his current account at the bank. A bank statement as at 30 June 20X0 showed that Cook has an overdraft of CU35. On checking the cash book and the bank statement you find the following.

- (a) Cheques drawn, amounting to CU500, had been entered in the cash book but had not yet been presented.
- (b) Cheques received, amounting to CU400, had been entered in the cash book, but had not yet been credited by the bank.
- (c) On instructions from Cook on 30 June 20X0 the bank had transferred CU60 interest received on his savings account to his current account, but it only recorded the transfer on 5 July 20X0. This amount was credited in the cash book on 30 June 20X0.
- (d) Bank charges of CU35 shown in the bank statement had not been entered in the cash book.
- (e) The payments side of the cash book had been undercast by CU10.
- (f) Dividends received of CU200 had been paid direct into the bank and not entered in the cash book.
- (g) A cheque for CU50 from Sunil was recorded and banked on 24 June. This was returned unpaid on 30 June and then shown as a debit on the bank statement. No entry has been made in the cash book for the unpaid cheque.
- (h) A cheque issued to Jones for CU25 was **replaced** when it was more than six months old, at which time it had become 'out of date' and the bank would have refused to pay it. It was entered again in the cash book, no other entry being made. Both cheques were included in the total of unpresented cheques shown above.

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It was entered again in the cash book, no other entry being made.

Both cheques were included in the total of unpresented cheques shown above.

1st cheque- Not reversed

Jones Dr 25
Cash Dr 25

2nd cheque

Jones Dr 25
Bank Cr 25

Problem:7

Bank reconciliation

Tilfer's bank statement shows CU715 direct debits and CU353 investment income not recorded in the cash book. The bank statement does not show a customer's cheque for CU875 entered in the cash book on the last day of the accounting period. The cash book has a credit balance of CU610.

What balance appears on the bank statement?

Types of error in accounting

There are **five broad types of error** as follows.

- ▶ **Transposition** errors

When two digits in an amount are accidentally recorded the wrong way round

- ▶ Errors of **omission**

Failing to record a transaction at all, or making a debit or credit entry, but not the corresponding double entry.

- ▶ Errors of **principle**

Making a double entry in the belief that the transaction is being entered in the correct accounts, but subsequently finding out that the accounting entry breaks the 'rules' of an accounting principle or concept. A typical example of such an error is to treat revenue expenditure incorrectly as capital expenditure.

- ▶ Errors of **commission**

A mistake is made in recording transactions in the ledger accounts.

- ▶ **Compensating errors**

Errors which are, coincidentally, equal and opposite to one another.

Correcting errors

- ▶ Errors which have not caused an imbalance are corrected via journals.
- ▶ Errors which have broken the rules of double entry bookkeeping and result in the trial balance failing to balance can be corrected by (1) setting up a suspense account and then (2) clearing it with correcting journals.
- ▶ A suspense account may also be deliberately set up when a bookkeeper does not know where to put one side of an entry.
- ▶ Suspense accounts are always temporary and should never appear in financial statements; these should not be prepared until the errors have been corrected and the suspense account has been cleared.
- ▶ Some corrections of errors will result in adjustments to a draft profit calculated while there were still errors in the accounts.

Problem:8

Journal entries

Write out the journal entries which would correct these errors.

- (a) A business receives an invoice for CU250 from a supplier which was omitted from the books entirely.
- (b) Repairs worth CU150 were incorrectly debited to the non-current asset (machinery) account instead of the repairs account.
- (c) The bookkeeper of a business reduces cash sales by CU280 because he was not sure what the CU280 represented. In fact, it was drawings.
- (d) Telephone expenses of CU540 are incorrectly debited to the electricity account.
- (e) A page in the sales day book has been added up to CU28,425 instead of CU28,825.

Suspense accounts

Suspense account: An account showing a balance equal to the difference in a trial balance.

A suspense account is a **temporary** account which can be opened for the following reasons.

- ▶ A trial balance is drawn up which **does not balance** (i.e. total debits do not equal total credits).
- ▶ The bookkeeper of a business knows where to post one side of a transaction, **but does not know where to post the other side**. For example, a cash payment must obviously be credited to cash, but the bookkeeper may not know what the payment is for, and so will not know which account to debit. To complete the double entry, he debits suspense

In both these cases, a **suspense account** is opened up until the problem is resolved.

Using a suspense account when the trial balance does not balance

When an error has occurred which results in an imbalance between total debits and total credits in the ledger accounts:

Step 1

Open a suspense account with the amount of the imbalance

Step 2

Use a journal entry to clear the suspense account and correct the error. It is good practice for the correcting side of the double entry to appear first in the journal, then the suspense account entry.

Errors

At T Down & Co year end, the trial balance contained a suspense account with a credit balance of CU1,040. Investigations revealed the following errors.

- (i) A sale of goods on credit for CU1,000 had been omitted from the sales account.
- (ii) Delivery and installation costs of CU240 on a new item of plant had been recorded as revenue expenditure in the distribution costs account.
- (iii) Cash discount of CU150 had been taken on paying a supplier, JW, even though the payment was made outside the time limit. JW is insisting that CU150 is still payable.
- (iv) A raw materials purchase of CU350 had been recorded in the purchases account as CU850, but the trade payables account was correctly written up.
- (v) The purchases day book included, a credit note for CU230, as an invoice in the total column. The correct entry was made in the purchases account.

~~Purchase Dr~~
~~Payable Cr~~

~~Payable dr~~
~~Purchase Cr~~

Payable Dr- 230+230= 460 Dr
Suspense A/C Cr 460

Requirements

- (a) Prepare journal entries to correct *each* of the above errors. Narratives are *not* required.
- (b) Open a suspense account and show the corrections to be made.
- (c) Before the errors were corrected, T Down & Co's gross profit was calculated at CU35,750 and the net profit for the year at CU18,500. Calculate the revised gross and net profit figures after correction of the errors.

Thank you

